1988

Bagley Corporation v. Virginia Beach Federal Savings and Loan Association,Guaranty Northstate, Northstate Savings and Loan of Southern Pines, Atlantic Permanent Federal, Jefferson Savings and Loan, William T. Blair, Jr., William H. Bandy, Harry H. Knickerbocker, T. Linwood May, Nancy Bolten, John Livingstone, J. Rutherford, The Jeremy, Ltd., Jeremy Service Corporation, and Associated Title Company, Inc. : Brief of Appellant

Utah Court of Appeals

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IN THE SUPREME COURT OF THE STATE OF UTAH

* * * * * * * *

BAGLEY CORPORATION, a Utah corporation, GERALD H. BAGLEY, an individual, individually and derivatively for and on behalf of THE JEREMY, LTD., a Utah limited partnership,	Supreme Court Appeal No. 860418
Plaintiffs/Appellants	
vs.	
VIRGINIA BEACH FEDERAL SAVINGS AND LOAN ASSOCIATION, a foreign corporation, GUARANTY NORTHSTATE, fka NORTHSTATE SAVINGS AND LOAN OF SOUTHERN PINES, a foreign corporation, ATLANTIC PERMANENT FEDERAL, a foreign corporation, JEFFERSON SAVINGS & LOAN, a foreign corporation, WILLIAM T. BLAIR, JR., WILLIAM H. BANDY, HARRY H. KNICKERBOCKER, T. LINWOOD MAY, NANCY BOLTEN, JOHN LIVINGSTONE and J. RUTHERFORD, individuals, THE JEREMY LTD., a Utah limited partnership, JEREMY SERVICE CORPORATION, a Utah corporation, and ASSOCIATED TITLE COMPANY, INC., a Utah corporation,	District Court Civil No. 8725
Defendants/Respondents.	

88-0120-CA

* * * * * * * *

BRIEF OF APPELLANT

Appeal from an order dismissing plaintiff's derivative claims in the Third Judicial District, in and for Summit County, State of Utah, the Honorable Scott Daniels, District Court Judge, presiding.

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IN THE SUPREME COURT OF THE STATE OF UTAH

* * * * * * * *

BAGLEY CORPORATION, a Utah corporation, and GERALD H. BAGLEY, an individual, individually and derivatively for and on behalf of THE JEREMY, LTD., a Utah limited partnership, Plaintiffs/Appellants vs. VIRGINIA BEACH FEDERAL SAVINGS AND LOAN ASSOCIATION, a foreign corporation, GUARANTY NORTHSTATE, fka NORTHSTATE SAVINGS AND LOAN OF SOUTHERN PINES, a foreign corporation, ATLANTIC PERMANENT FEDERAL, a foreign corporation, JEFFERSON SAVINGS & LOAN, a foreign corporation, WILLIAM T. BLAIR, JR., WILLIAM H. BANDY, HARRY H. KNICKERBOCKER, T. LINWOOD MAY, NANCY BOLTEN, JOHN LIVINGSTONE and J. RUTHERFORD, individuals, THE JEREMY LTD., a Utah limited partnership, JEREMY SERVICE CORPORATION, a Utah corporation, and ASSOCIATED TITLE COMPANY, INC., a Utah corporation, Defendants/Respondents.	Supreme Court Appeal No. District Court Civil No. 8725

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> **Partner accountable as a fiduciary.** Every partner must account to the partnership for any benefit, and hold as trustee for it any profits, derived by him without the consent of the other partners from any transaction connected with the formation, conduct or liquidation of the partnership or from any use by him of its property.
>
> This section applies also to the representatives of a deceased partner engaged in the liquidation of the affairs of the partnership as the personal representatives of the last surviving partner.

> **Rights, powers and liabilities of a general partner.** A general partner shall have all the rights and powers, and be subject to all the restrictions and liabilities, of a partner in a partnership without limited partners, except that without the written consent or ratification of the specific act by all the limited partners, a general partner or all of the general partners have no authority to:
>
> (1) Do any act in contravention of the certificate.
>
> (2) Do any act which would make it impossible to carry on the ordinary business of the partnership.
>
> (3) Confess a judgment against the partnership.
>
> (4) Possess partnership property, or assign their rights in specific partnership property, for other than a partnership purpose.
>
> (5) Admit a person as a general partner.
>
> (6) Admit a person as a limited partner, unless the right so to do is given in the certificate.

(7) Continue the business with partnership property on the death, retirement or insanity of a general partner, unless the right so to do is given in the certificate.

Rights of a limited partner. (1) A limited partner shall have the same rights as a general partner to:

(c) Have dissolution and winding up by decree of court.

Parties to actions. A contributor, unless he is a general partner, is not a proper party to proceedings by or against a partnership, except where the object is to enforce a limited partner's right against or liability to the partnership.

Common law adopted. The common law of England so far as it is not repugnant to, or in conflict with, the constitution or laws of the United States, or the constitution or laws of this state, and so far only as it is consistent with and adapted to the natural and physical conditions of this state and the necessities of the people hereof, is hereby adopted, and shall be the rule of decision in all courts of this state.

Effect of absence from state.---If when a cause of action accrues against a person when he is out of the state, the action may be commenced within the term herein limited after his return to the state; and if after a cause of action accrues he departs from the state, the time of his absence is not part of the time limited for the commencement of the action.

fewer than all the parties shall not terminate the action as to any of the claims or parties, and the order or other form of decision is subject to revision at any time before the entry of judgment adjudicating all the claims and the rights and liabilities of all the parties.

C. CITATIONS TO AUTHORITIES

STATEMENT OF THE ISSUE

1. Do the provisions of §48-2-26 U.C.A. (1953) abrogate the common law right of a limited partner to sue derivatively to protect or enforce the rights of the partnership where the general partner refuses to act because of a conflict of interest.

NATURE OF THE CASE

This is an appeal from a final order certified pursuant to Rule 54(b) of the Utah Rules of Civil Procedure from the Third Judicial District Court in and for Summit County, State of Utah, Honorable Scott Daniels, Judge. All defendants except Associated Title Company joined in the Motion of the lenders, Virginia Beach Federal Savings & Loan, Guaranty Northstate, Atlantic Permanent Federal and Jefferson Savings & Loan, to dismiss plaintiffs' Verified Complaint before issue was joined. The defendants claim that the plaintiffs' Complaint failed to state a claim upon which relief could be granted because Section 48-2-26, Utah Code Annotated (1953) prohibits limited partners in a limited partnership from suing derivatively to protect the interests of the partnership, even where the general partner fails or refuses to protect the interests of the partnership.

The Motion was decided solely upon the allegations of the Complaint and the authority cited in memoranda and argument of the parties and without the aid of affidavits, depositions or other discovery. The Order of Dismissal entered by the court, appended hereto as Appendix A, reflects the ruling of the court. The trial court held that the statutory authority cited above must be interpreted to prohibit the right of limited partners to sue derivatively on behalf of the limited partnership. As the Order dismissed all derivative claims filed by plaintiffs on behalf of the limited partnership, the plaintiff sought and obtained Rule 54(b) certification of the derivative

claims for immediate appeal.

STATEMENT OF FACTS

As relevant here, the gravamen of the plaintiffs' Verified Complaint is that the general partner of The Jeremy, Ltd. has breached the fiduciary duties it owes the limited partnership, and that it is unwilling to initiate action to protect the partnership because to do so would require that it sue itself and the various financial institutions that control it. These assertions are based upon the following factual allegations, which, for the purpose of this appeal from an order of dismissal, must be accepted as true. See, Murray v. City of Milford, Connnecticut, 380 F.2d 468, 470 (2nd Cir. 1967). All of the following citations refer to paragraphs of the Verified Complaint as paginated in the Record on Appeal.

The Jeremy, Ltd. is a Utah limited partnership. Paragraph 1, R. p.2. The Jeremy, Ltd. was formed by plaintiffs Gerald H. Bagley and Bagley Corporation in order to develop certain property situate in Morgan and Summit Counties, State of Utah. This development is known as The Jeremy Ranch. Gerald H. Bagley was the original general partner of The Jeremy, Ltd. Paragraph 17, R. p.5. Additionally, Gerald H. Bagley and Bagley Corp. (hereinafter collectively known as "plaintiffs") own approximately 75% of the limited partnership interests of The Jeremy, Ltd. Paragraph 15, R. p.4.

In 1982, The Jeremy, Ltd. required capital to pay off the loan with which the partnership property was initially purchased and to fund the construction and development of The Jeremy

Ranch. Paragraph 24, R. p.6. Through a series of negotiations conducted through Richards-Woodbury Mortgage Company, The Jeremy, Ltd. eventually reached an agreement with Virginia Beach Federal Savings & Loan, Guaranty Northstate, Atlantic Permanent Federal, and Jefferson Savings and Loan (hereinafter collectively referred to as "lenders") for a loan of $12,500,000.00. This loan was secured by a first deed of trust encumbering substantially all of the property of the partnership. Paragraphs 25-27, R. pp. 6-7. The lenders issued a formal commitment letter concerning the loan in August, 1982, and represented that the loan would close within three to six weeks thereafter. Paragraphs 27-30, R. p.7. The lenders required that a 5% loan fee ($625,000.00) be paid at the time the commitment letter was issued, even though the actual loan had not closed. Paragraphs 28, 31, R. p.7. In order to meet this demand of the lenders, Gerald H. Bagley and The Jeremy, Ltd. executed a promissory note payable to the lenders or their designees in the amount of $625,000.00. Paragraph 30, R. p.7.

In reliance upon the lenders' repeated representations that the loan would soon close and the loan funds would then be available, plaintiffs made commitments to contractors and commenced construction. Paragraphs 27, 30, 36, R. pp. 7-8. However, the loan did not close until December, 1982. Paragraph 31, R. p.7. At this point, plaintiffs were at risk on the $625,000.00 note and had been incurring debt in order to maintain construction through the fall of 1982. Paragraphs 28, 36-37, R. pp. 7-8.

The lenders knew that the repayment schedule and other

information used to qualify for the loan were based upon the assumption that the loan would close and fund in August, 1982. Paragraphs 32-34, R. pp.7-8. When the loan documents were finally presented to the plaintiffs, the lenders' delay had already forced the plaintiffs into a position where they had no economic choice but to execute the documents because of the commitments they had made with contractors and because of plaintiffs' liability on the note that had been executed in order to pay the commitment fee. This position was the result of the lenders' delay in closing the loan, contrary to earlier representations the lenders had made to plaintiffs. No negotiation of the loan documents was permitted by the lenders. Paragraphs 38-39, R. p.8.

After the loan closed in December, 1982, the lenders further delayed and inhibited the development of the project and thus plaintiffs' ability to perform under the terms of the loan agreement by intentionally and wrongfully delaying the funding of construction draws that the lenders were obligated to pay. From July, 1983 through February, 1984, the lenders repeatedly delayed paying valid and proper draws on the construction loan. Paragraphs 44-48, R. pp.9-10.

Because of the repeated and wrongful delays by the lenders in performing their obligations, many of the contractors working on the project were not paid, and subsequently stopped work. This caused additional delays and expenses in the completion of the project. Paragraph 45, R. p.9. The lenders were fully aware that the delays caused by them in completion of improvements were

delaying and inhibiting the ability of the plaintiffs to sell Jeremy Ranch lots, upon which timely repayment of the loan depended. Paragraph 46, R. p.9.

In February, 1984, the lenders finally funded the draws necessary to pay existing contractor debts. Paragraph 48, R. p.10. Unfortunately, by this point it was necessary for the plaintiffs to borrow an additional $6.8 million to pay for cost overruns, construction, interest and other expenses. Paragraph 49, R. p.10.

In the fall of 1984 the lenders (through their agent Causey Davis) interfered in the management of The Jeremy, Ltd. by demanding that plaintiff Bagley, as general partner, require approximately 200 persons who had purchased "reservations" on Jeremy Ranch lots to select their lots and pay the balance of their obligations within thirty days. Paragraphs 50-51, 55, R. pp.10-11. The original terms of the reservation agreements had required two payments; $25,000.00 down and $25,000.00 upon completion of the lot improvements. The original timetable had set completion dates of 1984 for plat IV of the project and 1985 for plat V, but, as described above, the actions of the lenders had made compliance with this schedule impossible. Paragraph 51, R. p.10. The actions of the lenders forced plaintiffs to breach their contracts with the various reservation holders. Paragraphs 56, 58, R. p.11. Plaintiffs and the partnership objected, claiming the demands would cause a "run on the bank" by disgruntled reservation holders who could demand rescission and the return of their $25,000 deposits. Paragraph 57, R. p.11.

When plaintiffs objected to the lenders' demands, the lenders threatened to call the loans and foreclose on the partnership property. Paragraph 58, R. p.11. The alleged default was failure to comply with construction and sales projections. The lenders' own conduct in delaying construction draws against the loan had contributed to or caused the alleged default. Paragraph 46, R. p.9. Under protest and duress, plaintiff made the demand upon lot reservation holders required by the lenders. The demand required The Jeremy, Ltd. to breach the lot reservation agreements. As a result of the breach of the reservation contracts, numerous reservation holders demanded rescission and the return of their reservation deposits: Paragraphs 56-59, R. p.11. The general partner paid rescission demands totalling almost $1,000,000.00. The attempt to meet these rescission demands exhausted the cash reserves of The Jeremy, Ltd. and certain individual partners of The Jeremy, Ltd. including Dr. Gerald Bagley. Paragraph 60, R. p.12.

Because of the actions of the lenders described above and adverse weather conditions beyond plaintiffs' control, by December, 1984, the resources of The Jeremy, Ltd. were nearly exhausted and the construction schedule was even further in arrears. Paragraph 64, R. p.12. At this point the lenders, under renewed threat of foreclosure, demanded control of The Jeremy, Ltd. Paragraph 65, R. p.12. The lenders proposed the formation of a new corporation, ultimately known as the Jeremy Service Corporation, (hereafter "JSC") which would assume control of The Jeremy, Ltd. by replacing Dr. Gerald Bagley as its general

partner. Paragraph 66, R. p.13. In order to quell the objections and resistance of the limited partners to the lenders' demand for control, the lenders promised that they would perform a number of acts for the benefit of the partnership, its partners and its creditors. Specifically, the lenders promised that if the limited partners approved the JSC scheme, the lenders would cause and assist JSC to do the following:

a. Pay sums owed by The Jeremy, Ltd. to its creditors including lot reservation holders and others;

b. Pay off all contractors who were owed money on the project;

c. Formulate a development and marketing plan for the year 1985 and aggressively market the project and act in its best interest so that it could generate funds to repay the loans owed to the lenders and others;

d. Curb and eliminate negative rumors and information about the project through a positive public relations program and through the timely payment of debts and obligations of The Jeremy, Ltd.;

e. Issue deeds to lots to all those who were entitled to them because of payment of purchase price or otherwise (some lot reservation holders had elected to purchase their lots and had paid or tendered the balances owing but could not obtain clear title unless the lenders released their liens reflected by the deeds of trust);

f. Act responsibly and maintain a fiduciary obligation to the partnership and its limited partners;

g. Maintain the equity and value of The Jeremy, Ltd. and the property owned by it; and

h. Protect the Bagley interests and the interests of the limited partners by permitting Gerald Bagley an advisory role in the operation of The Jeremy, Ltd. and a seat on the board of directors of JSC. Paragraph 67, R. p.13.

The lenders' failure to perform according to these covenants forms the basis for a number of the claims that the general partner of The Jeremy, Ltd. should bring against the lenders. Paragraphs 118-120, R. pp. 25-26. Instead, not only has the general partner failed to bring these claims, it has systematically breached its fiduciary duties to the partnership and acted to place the interests of the individual lenders before those of the partnership. Paragraphs 74-95, R. pp. 15-20.

The substitute general partner, JSC, is a transparent alter ego of the lenders. The stock of JSC is owned entirely by the lenders or their nominees. Its directors are now exclusively officers or employees of the lenders, dependent upon the lenders for their livelihoods. As such, the board is captive to the will of the lenders. Various other officers of the lenders who are not directors of JSC sit and participate in its board meetings, often making motions or directing the votes of the other directors with impugnity. Paragraphs 74-75, R. p.15.

The documents that substitute control of the limited partnership were drafted by lenders' counsel, as were the documents for the creation of JSC. These documents were not negotiable when presented for signature to the partners of the

limited partnership. They unconscionably required the limited partners to consent to the lenders' demand that the new general partner could ignore its fiduciary duty to the partnership and its limited partners and act in the best interests of the lenders. Paragraphs 69-72, R. p. 14.

Jeremy Service Corporation as general partner of The Jeremy, Ltd. has failed and refused to bring suit against the lenders for the acts of the lenders that took place both before and after the change of control. Obviously JSC will not sue the lenders. The directors of JSC are the officers or employees of the individual lenders. JSC is an alter ego of the lenders. It is for this reason that plaintiffs have been forced to assert the instant derivative claims on behalf of The Jeremy, Ltd.

Additionally, JSC has failed to assert against itself the causes of action that the partnership has against it for breaches of the fiduciary duty it owes the partnership. The specific facts concerning JSC's defalcations of duty are set forth at paragraph 152 (a)-(i), R. pp. 31-33, of the Verified Complaint. The crux of these allegations is that JSC has subordinated the interests of the partnership to those of the lenders, and has participated in and furthered the lenders' conspiratorial attempts to wrongfully obtain the partnership's primary asset, the Jeremy Ranch. This failure to protect the partnership's interests is a breach of fiduciary duty in and of itself. If the plaintiffs are not allowed to assert these claims derivatively, the wrongs of the lenders and Jeremy Service Corporation will go unredressed.

SUMMARY OF ARGUMENT

I. A LIMITED PARTNER IN A UTAH LIMITED PARTNERSHIP HAS A COMMON LAW RIGHT TO BRING A DERIVATIVE ACTION ON BEHALF OF THE PARTNERSHIP WHEN THE GENERAL PARTNER IS UNABLE OR UNWILLING TO DO SO.

A general partner owes a fiduciary duty to the limited partnership. If the general partner refuses or is unable to take action on behalf of the partnership against itself or third parties, in breach of its fiduciary duty, equity provides the limited partner a right to sue derivatively in order to protect the partnership interests. The source of the derivative right lies in the common law doctrine that equity will suffer no right to be without a remedy. The right is analogous to the rights of a corporate shareholder and a cestui que trust.

As a part of the common law, the derivative right of a limited partner has been adopted as the law of this state unless the Legislature has expressly or implicitly stated otherwise.

II. U.C.A. §48-2-26 (1953) DOES NOT ABROGATE THE COMMON LAW RIGHT OF A LIMITED PARTNER TO SUE ON BEHALF OF THE PARTNERSHIP WHEN THE GENERAL PARTNER REFUSES OR IS UNABLE TO DO SO.

The Utah Limited Partnership Act does not expressly prohibit the exercise of a limited partner's derivative right. The issue before this court is whether U.C.A. §48-2-26 should be construed as implicitly barring the derivative action. Section 26 states:

> A contributor, unless he is a general partner, is not a proper party to proceedings by or against a partnership, except where the object is to enforce a limited partner's right against or liability to

the partnership.

The court's primary objective in resolving this issue must be to give effect to the legislative purpose of the statute. The actual purposes of Section 26 were to reaffirm the limited liability and removal from management of a limited partner. An examination of the history and circumstances surrounding the Uniform Limited Partnership Act ("ULPA") compels the conclusion that Section 26 was not intended to bar derivative suits by limited partners. The drafters of the ULPA did not envisage the possible need for a derivative action. Thus, they could not have intended Section 26 as a bar to such.

As Section 26 was not intended to bar derivative actions by limited partners, the question becomes whether it was proper to so apply it. In this regard, it is recognized that in order to give a statute implementation that will fulfill its purpose, reason and intention sometimes prevail over technically applied literalness.

Section 26 must be construed in light of and consistently with the objective of the ULPA as a whole. The primary purpose of the Act was to encourage investment in the limited partnership form of business entity. If this court construes Section 26 to deny limited partners the right to protect the partnership against the self-dealing and breaches of fiduciary duty by corporate general partners it will discourage investment in limited partnerships and defeat the purpose for which the ULPA was enacted in Utah.

Statutes presumptively are intended not to produce absurd or

inequitable consequences. The legislature could not have intended Section 26 to prohibit the enforcement of a general partner's fiduciary duty to the partnership. The contrary conclusion is both absurd, in that it concedes a duty but denies the ability to enforce it, and inequitable, in that it leaves the partnership without a remedy for injury caused by the general partner's defalcations.

To interpret Section 26 as a bar to derivative actions will expose Utah's limited partners to injury caused by self-dealing, undercapitalized corporate general partners. This result runs contrary to the court's duty to interpret laws in ways which will best protect the public.

To hold, consistent with the rules of statutory construction considered herein, that Section 26 does not abrogate a limited partner's common law derivative right will place Utah among the majority of those jurisdictions that have carefully considered the issue. The opinions reaching the contrary conclusion have failed to consider the issue in any depth. Those opinions have little if any persuasive value for this court.

Finally, the policy arguments commonly made against the recognition of the common law right are flawed in that they ignore the self-limiting prerequisite showing of the general partner's inability or wrongful refusal to bring partnership claims.

The interpretation of U.C.A. §48-2-26 (1953) by the District Court was error. Its decision must be reversed and this cause remanded for further proceedings.

ARGUMENT

I. A LIMITED PARTNER HAS A COMMON LAW EQUITABLE RIGHT TO SUE ON BEHALF OF THE PARTNERSHIP WHEN THE GENERAL PARTNER IS UNWILLING OR UNABLE TO PROTECT THE PARTNERSHIP INTERESTS.

> Beginning with the landmark decision of Klebanow v. New York Produce Exchange, 344 F.2d 294 (2d Cir. 1965), the majority of jurisdictions to have considered the issue have concluded that, under the common law, a limited partner may bring a derivative action against the general partners for breach of fiduciary duty in the management of the affairs of the partnership if the general partners refuse or are unable to bring such an action.

Moore v. 1600 Downing St., Ltd., 668 P.2d 16, 19 (Colo.App.1983) (emphasis original) citing, Riviera Congress Associates v. Yassky, 18 N.Y.2d 540, 277 N.Y.S.2d 386, 223 N.E.2d 876 (1966); McCully v. Radack, 27 Md.App. 350, 340 A.2d 374 (1975); Smith v. Bader, 458 F.Supp. 1184 (S.D.N.Y.1978) (applying California law); Strain v. Seven Hills Associates, 75 A.D.2d 360, 429 N.Y.S.2d 424 (1980) (applying Ohio law); Engl v. Berg, 511 F.Supp. 1146 (E.D.Pa.1981); Phillips v. KULA 200, Wick Realty, Inc., 629 P.2d 119 (Haw.App.1981); Jaffe v. Harris, 109 Mich.App. 786, 312 N.W.2d 381 (1981).

The basis of the right of a limited partner to bring a derivative action when the general partners are unable or unwilling to protect the partnership's (and thus, indirectly, the limited partner's) interests lies in the well-established principle that "equity will suffer no right to be without a remedy." See, Chantler v. Wood, 6 Ariz.App. 134, 430 P.2d 713, supp'd 6 Ariz.App. 325, 432 P.2d 469 (1967); Stephanus v.

Anderson, 26 Wash.App. 326, 613 P.2d 533 (1980); 27 Am.Jur.2d "Equity" §120, p. 647 (1966). A general partner in a limited partnership is accountable to the partnership as a fiduciary. U.C.A. §48-1-18 (1953) (applied to general partners in a limited partnership by U.C.A. §48-2-9 (1953)): See also, Burke v. Farrell, 656 P.2d 1015, 1017 (Utah 1982) (with respect to general partnership); Elk River Associates v. Huskin, 691 P.2d 1148 (Colo.App.1984); Phillips v. KULA 200, Wick Realty, Inc., 2 Haw.App. 206, 629 P.2d 119 (1981). The existence of this fiduciary duty places the limited partners of the partnership in a position similar to that of a preferred stockholder in a corporation or the beneficiary of a trust vis-a-vis the corporate management or the trustee. Though neither preferred stockholders nor trust beneficiaries ordinarily have the right to participate in the management of the corporation or trust, equity provides them with a remedy to protect their interests, by protecting the corporation or trust when the corporate management or the trustee is unable or unwilling to do so. This remedy is the derivative action. Utah law recognizes the derivative right in these analogous situations. See, e.g., U.R.C.P. 23.1 (1953); Salina Canyon Coal Co. v. Klemm, 76 Utah 372, 290 P. 161, 167 (1930); Rest. Trusts 2d §282, p. 44 (1959).

Similarly, equity provides a limited partner with the remedy of a derivative action to protect the partnership when the general partner is unable or unwilling to do so. In the absence of a derivative action under these circumstances, the partnership would be powerless to enforce the fiduciary duty owed to it by

the general partner. The partnership would have a right with no remedy. The derivative action is the only means by which a limited partnership can be protected against the defalcations of a general partner or against collusion by the general partner with third parties or parties that control the general partner of the partnership.

The facts in Riviera Congress Assoc. v. Yassky, 223 N.E. 2d. at 876, are similar to those at hand and illustrate the need for a derivative action in such circumstances. Riviera Congress Associates owned a motel in New York City. The general partners of Riviera leased the motel to The Yassky Corporation which they also owned. The lease was "noncancelable" but could be assigned with the consent of the general partners provided the assignee assumed all of the tenant's obligations. Thus, Riviera was entitled to rental payments on the motel for 20 years, and would own a cause of action for this rent if the tenant (Yassky Corp.) stopped payment.

The subsequent transactions involving the lease are complex, but what essentially happened was that the individuals who were the general partners of Riviera consented to a series of assignments and subleases of Yassky's leasehold interest in the motel. All of these transfers were to corporations or partnerships that were controlled and owned by the general partners of Riviera. None of the tenants could operate the motel at a profit. This created a conflict of interest for the general partners of Riviera. While they had a fiduciary duty to Riviera to enforce the lease and procure the monthly rental payments,

they owned the tenant which was operating the motel at a substantial loss. Thus, they also had an interest in releasing the tenant from its obligation on the 20 year lease. Eventually, the general partners agreed to an assignment of the lease to a corporate subsidiary of Riviera. This put Riviera in possession of the motel without an independent tenant. The general partners then advised the limited partners that, due to current financial losses by the operating lessee, the general partners, on behalf of the partnership, had accepted a surrender of the operating lease. The limited partners who had previously shared in the fixed rental derived from the property thereafter ceased to receive any return on their investments.

Under these facts, the partnership had no remedy unless the limited partners were able to sue derivatively to set aside the final lease assignment and force the payment of rent. The rental obligation ran to Riviera, as landlord, and not to the limited partners. Accordingly, the suit for rent had to be brought by Riviera or someone entitled to sue on its behalf. The general partners would not sue because they were losing more money operating the motel than they would obtain from their share of the rent as general partners of Riviera. Thus, the derivative action was the logical and necessary remedy to enforce the partnerships' rights. See, Id. at 879.

The facts in the instant case also demonstrate the need for a derivative right to provide an effective remedy to the partnership for a breach of the duty it is owed. Here, as in Riviera, the general partner is paralyzed from enforcing the

rights of the partnership due to a conflict of interest. To obtain the redress to which the partnership is entitled, JSC must sue itself and the lenders which control it. Without a derivative action, the partnership has rights without a remedy. While limited partners can sue to enforce their own rights and recover personal damages for breach of fiduciary duty by the general partner, the partnership's claims, premised upon the same facts and circumstances, will not be pursued unless the limited partners may sue derivatively on behalf of the partnership. The inequity of this scenario is precisely why the majority of modern authority recognizes the limited partner's derivative right under common law equitable principles.

As the court noted in Riviera:

> There can be no question that a managing or general partner of a limited partnership is bound in a fiduciary relationship with the limited partners . . . and that the latter are, therefore, cestuis que trustent [sic] . . . . It is fundamental to the law of trusts that the cestuis have the right, "upon the general principles of equity" . . . and "independently of [statutory] provisions" . . . to sue for the benefit of the trust on a cause of action which belongs to the trust if "the trustees refuse to perform their duty in that respect".

Id., at 879. (citations omitted) (brackets in original). The court in Riviera went on to hold:

> Since its general partners will not sue because they are the very persons who would be liable for payment of the rent, the limited partners, as cestuis que trustent, [sic] should be permitted to initiate the necessary legal proceedings on behalf of the Syndicate.

223 N.E. 2d at 880.

This holding is on all fours with the situation at hand. Since

JSC will not assert the partnership's claims against itself and the lenders for which it serves as alter ego, plaintiffs must be allowed to do so.

The other "remedies" available to a limited partner for a breach of the general partner's fiduciary duty do not eliminate the need for a derivative action, particularly in a situation such as in the instant case. Arguably, limited partners in plaintiffs' position could "protect their rights" by causing a dissolution and winding up of the partnership. Alternatively, the plaintiffs could sue the general partner directly for the damages caused them because of the breach of duty. It is immediately apparent that neither of these actions benefit the partnership. Furthermore, these actions could result in only a Pyrrhic victory for the individual limited partners. If, as here, the general partner is an undercapitalized corporation, the assets of the partnership could be squandered or transferred to third parties with impugnity, leaving the limited partners with only a "shell" from which to recover. It is critical that the limited partners be able to protect the partnership as a viable, living entity in and of itself. Thus the derivative right is absolutely necessary as an effective means of remedying breaches of the duty owed to the partnership and its partners.

Recognition of this common law, equitable right is entirely appropriate under U.C.A. §68-3-1 (1953) which adopts the common law "so far as it is not repugnant to, or in conflict with, the Constitution or laws of the United States, or the Constitution or laws of this state, and so far only as it is consistent with and

adapted to the natural and physical conditions of this state and the necessities of the people hereof." Id. Therefore, a limited partner in a Utah limited partnership has a common law right to bring an action on behalf of the partnership when the general partner is unable or unwilling to protect the partnership's interests.

In summary, the general partner of a limited partnership owes the partnership strict fiduciary duties. The limited partners of the partnership are the indirect beneficiaries of these duties. If the general partner is unable or unwilling to protect the partnership's interests, equity provides the limited partners with the right to do so derivatively. This right is founded in the common law, and is based upon the principal that equity will suffer no right to be without a remedy. Utah recognizes the derivative rights of corporate shareholders and trust beneficiaries, who are in positions analogous to that of a limited partner. Further, Utah has adopted the common law to the extent that it is not inconsistent with the federal and state Constitutions or laws. Therefore, this Court should recognize the equitable right of a limited partner to sue on behalf of the partnership when the general partner is unable or unwilling to do so.

II. THE LANGUAGE OF U.C.A. §48-2-26 (1953) SHOULD NOT BE READ TO PROHIBIT THE EXERCISE OF A LIMITED PARTNER'S RIGHT TO SUE ON BEHALF OF THE PARTNERSHIP WHEN THE GENERAL PARTNER IS UNABLE OR UNWILLING TO PROTECT THE PARTNERSHIP'S INTERESTS.

While the transcript of the hearing and oral argument on defendants' motion to dismiss is rather ambiguous, it appears that the sole basis for the Order of Dismissal was that Judge Daniels believed that the language of U.C.A. §48-2-26 prohibited derivative claims by limited partners under any circumstances. At page 20, the Court states: "How do you get around the statute that says unless you're a general partner you're not a proper party from proceeding against the buyer of the partnership? I don't see how you read it any other way." Id., lines 13-16. R. p. 414. Similarly, at page 30, Judge Daniels is reported as saying, "I can't read this language saying anything else other than the limited partner can't be a -- bring against a partnership." Id., lines 11-13. R. p. 424. For the reasons that follow, the Court's interpretation of section 26 as absolutely prohibiting a derivative suit by a limited partner was error. The Order of Dismissal should be reversed, and the cause remanded for further proceedings.

A. The Rules Of Statutory Construction Preclude A Reading Of U.C.A. §48-2-26 (1953) That Prohibits Limited Partners From Exercising The Common Law Right To Bring A Derivative Action When The General Partner Is Unable Or Unwilling To Sue On Behalf Of The Partnership.

> A contributor, unless he is a general partner, is not a proper party to proceedings by or against a partnership, except where the object is to enforce a limited partner's right against or liability to

the partnership. U.C.A. §48-2-26 (1953)

In determining whether this provision bars the exercise of a limited partner's common law right to sue derivatively, this court must be guided by the doctrine that:

> [t]he fundamental consideration which transcends all others in regard to the interpretation and application of a statute is: What was the intent of the legislature? All other rules of statutory construction are subordinate to it and are helpful only insofar as they assist in attaining that objective.

Johnson v. State Tax Commission, 17 Utah 2d 337, 339, 411 P.2d 831, 832 (1966) and citations therein; See also, Christensen v. Industrial Commission, 642 P.2d 755, 756 (Utah 1982); Young v. Barney, 20 Utah 2d 108, 110, 433 P.2d 846, 847 (1967). Among the "other rules of statutory construction" subordinate to that requiring ascertainment of legislative intent is the rule advocating a literal application of statutory terms. Thus, it has been held that "[i]n the exposition of a statute the intention . . . will prevail over the literal sense of the terms; and its reason and intention will prevail over the strict letter." Young v. Barney, 433 P.2d at 847, (omission original) citing, Norvill v. State Tax Commission, 98 Utah 170, 97 P.2d 937, 126 A.L.R. 1318 (1940). Similarly, in rejecting the result apparently mandated by the literal wording of U.C.A. §78-12-35 (1953) (a provision tolling the statute of limitations on tort claims) this Court stated in Snyder v. Clune, 15 Utah 2d 254, 255, 390 P.2d 915, 916 (1964):

> [S]tatutes of necessity must state their objectives in general language. It is not always possible to foresee and prescribe in precise detail for all situations to which they might

> apply. Attempts to give them universal and literal application frequently lead to incongruous results which were never intended. When it is obvious that this is so, the statute should not be so applied.

Applying these rules to the situation at hand, the questions presented are: (1) Did the legislature intend section 48-2-26 as a bar to a limited partner's right to sue derivatively? (2) If not, was the trial court's "literal" application of the statute's terms appropriate and in accordance with established rules of statutory construction? Plaintiffs will show that section 26 was not intended as a bar to derivative actions by limited partners and that the trial court's interpretation of the statute was error as a matter of law. Therefore, the order of dismissal should be reversed and this cause remanded for further proceedings.

1. The Legislature Did Not Intend U.C.A. §48-2-26 (1953) As A Bar To Derivative Actions By Limited Partners.

Plaintiffs' research revealed no materials or authority concerning the legislative history of the Utah Limited Partnership Act as adopted in 1921. L. 1921, Ch. 88, §1 et seq. The Act was apparently the result of a verbatim adoption of the Uniform Limited Partnership Act (1916), hereafter the "ULPA". For this reason plaintiffs suggest that the history and intent behind the Uniform Act provide this court the most authoritative guide with which to determine whether U.C.A. Section 48-2-26 was intended to abolish the derivative right of

limited partners.

A review of the background and history of the ULPA reveals that section 26 was not intended as a bar to a limited partner's common law right to sue on behalf of the partnership when the general partner is unable or unwilling to protect the partnership's interests. What seems most likely is that the drafters of the ULPA did not foresee the possibility that situations such as that at hand might arise and did not anticipate the need for derivative protection in the context of the limited partnership.

In 1917 William Draper Lewis, the draftsperson of the committee that composed the ULPA, wrote:

> In the limited partnership the limited partner may be sure of the active interest of the general partners, who are the directors of the enterprise, because such partners are, while the directors of a corporation are not, liable without limit for the debts.

Lewis, "The Uniform Limited Partnership Act," 65 U. Pa. L. Rev. 715, 717 (1917). From this statement it is obvious that the drafters of the ULPA did not foresee that situations such as that presented here might arise. Because the drafters of the ULPA never imagined that a limited partner might have to sue derivatively to protect the partnership, they could not have intended that Section 26 prohibit such suits. This conclusion is supported both by judicial authority and scholarly opinion. See, Klebanow v. New York Produce Exchange, 344 F.2d 294, 298 (2dCir.1965); Comment, 40 N.Y.U.L.Rev. 1174, 1176 (1965) (Klebanow courts' finding that the draftsmen of the ULPA did not foresee the possibility of general/limited partner conflicts in

enforcing partnership claims "seems sound").

Dean Harold G. Reuschlein contends that the prominence of the "aggregate" theory of limited partnership (as opposed to the "entity" theory) during the drafting of the ULPA "in and of itself serves to explain the absence of a provision authorizing derivative suits by limited partners." H.G. Reuschlein, Limited Partner Derivative Suits, 9 St. Mary's L.J. 443 (1978). Under either analysis, it is clear that the drafters of the ULPA were not thinking of derivative actions when they composed Section 26.

Since Section 48-2-26 was not intended as a bar to limited partners' derivative actions, it can be argued that Rule 23.1 of the Utah Rules of Civil Procedure does provide for them. Rule 23.1 sets forth the requirements of the complaint in a derivative action by one or more "members" of an "unincorporated association." As the term unincorporated association "includes a limited partnership," "Rule 23.1 alone is broad enough in scope" to apply to this case. See Reuschlein, supra, 9 St. Mary's L.J. at 456 through 457.[1] The drafters of the ULPA did not intend that Section 26 be applied as a bar to derivative suits. It was error to so apply it.

2. The Three Actual Purposes Of Section 26 Are Reasonably Plain And Are Clearly Covered By The Statutory Language.

[1] Under this analysis, the current inquiry ends here and this case should be remanded for a determination of whether plaintiffs have complied with the rule. However, this issue was not argued below, and thus plaintiffs turn to the issue of whether Section 48-2-26, while not intended to bar derivative suits, should be so applied. To decide this issue, the actual purposes of Section 48-2-26 must be ascertained. Then it can be determined whether the trial court's decision was a proper extension of the statute in light of the rules of statutory construction.

As stated by Judge Friendly in Klebanow v. New York Produce Exchange, 344 F.2d at 298, the "true purpose" of section 26 was to provide that:

> General partners need not join limited partners in an action by the partnership; ordinarily limited partners may not sue since this will interfere with the management by the general partners . . .; a suitor against the partnership need not join a limited partner; indeed, he may not do so if the partnership be solvent (citations omitted).

Nowhere in Section 26 is a derivative action by limited partners expressly referenced or discussed. The statute does not expressly deny a limited partner's right to sue derivatively on behalf of the partnership. The issue thus becomes whether the intended objectives of the section are such that it should be extended to apply to the unforeseen situation where a derivative action is needed to protect the partnership. "Ordinarily, courts may not extend a statute to meet cases not within its scope or purview, however meritorious they may be." Black v. Plumb, 94 Colo. 318, 29 P.2d 708, 91 ALR 1334 (1934); 73 Am. Jur. 2d "Statutes" §149, p. 353. The prohibition against extending a statute beyond its intended purpose should weigh even more heavily when to do so will result in injustice.

3. Rules Of Statutory Construction Compel The Conclusion That Section 26 Should Not Be Extended To Bar Or Affect A Limited Partner's Equitable Right To Protect The Partnership When The General Partner Will Not.

A "statute should be looked at as a whole and in light of

the general purpose it was intended to serve; and should be so interpreted and applied as to accomplish that objective." Andrus v. Allred, 17 Utah 2d 106, 109, 404 P.2d 972, 974 (Utah, 1965) citing, Sutherland, Statutory Construction §5002 (3rd Ed. 1943). One of the primary objectives of the drafters of the ULPA was to stimulate and encourage investment in limited partnerships by eliminating the technical pitfalls of limited partnerships under prior acts. See, Lewis, supra, 65 U. Pa. L. Rev. 715 (1917).

> In light of this investment policy, it is reasonable to assume that the purpose of the statute will best be effectuated by limiting the application of section [26] to situations where general partners are actively interested and suit by limited partners would constitute interference. To rule otherwise -- forbidding limited partners under any circumstances to protect their investments -- would discourage investment by limited partners.

Comment, 40 N.Y.U. L. Rev. 1174, 1176 (1965). For this court to hold that section 26 prohibits a limited partner from protecting her investment and partnership rights against the breach of fiduciary duty of a corporate general partner would discourage investment in limited partnerships, contrary to the objective of the ULPA as a whole. This should not be done.

Next, "a statute is presumed not to be intended to produce absurd consequences and [where possible] will be given a reasonable and sensible construction." Curtis v. Harmon Electronics, Inc., 575 P.2d 1044, 1046 (Utah, 1978). To construe section 26 to prohibit derivative suits on behalf of the partnership is surely to foster an absurd result. If partners may not sue derivatively to protect partnership rights, their

most efficient remedy may be an action to dissolve the partnership. As one commentator has put it :

> Although a breach of fiduciary duty may give a limited partner a cause of action for judicial dissolution, [see, U.C.A. §48-2-10(c) (1953)] this remedy often will be akin to throwing out the baby with the bath water.

Hecker, "Limited Partners' Derivative Suits Under the Revised Uniform Limited Partnership Act," 33 Vand. L. Rev. 343, 349 (1980).

Statutes are not to be deemed to change or repeal the common law by implication, unless the intention to do so is obvious. Norfolk Redevelopment & Housing Authority v. Chesapeake & Potomac Tel. Co., 104 S.Ct. 304 (1983); 73 Am. Jur. 2d, "Statutes" §185 p. 386. The language of section 26 of the ULPA seems a peculiar way to say "A limited partner may not sue derivatively." Therefore, the provision should not be construed as implicitly abolishing the common law right.

The "law is presumed to be equitable, and it is a rule of construction that any ambiguity in a statute should be resolved in favor of an equitable operation of the law." Kerlin v. Ball, 1 Dall (Pa.) 175, 1 L.Ed. 88 (1786); 73 Am. Jur. 2d, "Statutes" §259, p. 428. An equitable operation of the law in this case requires the court to recognize the right of these plaintiffs to sue derivatively to protect the partnership. The general partner has openly subordinated the rights of the partnership to those of the lenders which control it. As the alter ego for the very parties from which redress is owed, the general partner cannot act to protect partnership interests. Equity mandates a

mechanism whereby the partnership's right to the fiduciary duties owed by its general partner can be enforced. Absent a derivative suit under these circumstances, any remedy for the partnership is imperfect.

Finally, this Court has a "duty to render such interpretation of the laws as will best promote the protection of the public." Curtis v. Harmon Electronics, Inc., 575 P.2d at 1046. Plaintiffs submit that an interpretation of U.C.A. §48-2-26 (1953) that will effectively give corporate general partners carte blanche to breach their fiduciary duties alone or in collusion with third parties will not best promote the protection of the public.

In summary, the legislature did not intend to bar derivative suits when enacting U.C.A. §48-2-26 (1953). This court should not extend the application of the statute, through judicial interpretation, to obliterate the common law right of a limited partner to protect the partnership when the general partner is unable or unwilling to do so. Such an interpretation is contrary to the general objective of the statute, will promote absurd results, and flies in the face of the demands of equity. The Order of Dismissal should be reversed.

B. Judicial Precedent Supports The Plaintiffs' Position That Section 26 Does Not Bar A Limited Partner's Right To Bring A Derivative Action When The General Partner Is Unable Or Unwilling To Protect The Partnership's Interests.

While there is an apparent split of authority as to whether statutory provisions identical to section 26 bar a limited partner's right to sue derivatively, an analysis of the case law reveals that, uniformly, the better reasoned cases have recognized that these provisions do not and should not affect this right.

The landmark case with respect to the issue is Klebanow v. New York Produce Exchange, 344 F.2d 294 (2d Cir. 1965). In Klebanow Judge Friendly posed the "novel" issue before the Second Circuit Court of Appeals as:

> [W]hether limited partners of a New York partnership in dissolution can sue on its behalf for damages claimed to have been inflicted on it by conduct proscribed by the federal antitrust laws, when the partnership and the liquidating partner allegedly have rendered themselves unable to sue and their delegate is claimed to be unwilling to do so because of affiliations with the defendants.

Id. at 295. The limited partners of Ira Haupt & Co. asserted that the partnership had a cause of action against the New York Produce Exchange for damages resulting from the Produce Exchange's alleged attempt to monopolize the cottonseed oil market. The original general partners could not bring the action because they had transferred all of their powers to an agent of the New York Stock Exchange subsequent to Haupt's insolvency. The complaint alleged that the Stock Exchange's agent, Mahoney, would not sue the Produce Exchange for Haupt because certain members of the Stock Exchange had ties to and membership in the Produce Exchange. Thus, if the limited partners were precluded from suing derivatively by section 115 of the New York

Partnership Law (identical to U.C.A. §48-2-26 (1953)) Haupt's $11 million antitrust claim would not have been brought.

The Klebanow court first recognized the existence of a limited partner's common law right to sue derivatively, as discussed above. Next, the court addressed the issue of whether Section 115 precluded the exercise of the right. Noting that the framers of the ULPA had not anticipated the issue at hand, the court discussed the actual purpose of section 115, which was to express the limited liability and the removal from management of limited partners. The court continued:

> The words say all this and say it well. But they do not have to be read as saying that a limited partner cannot bring an action on behalf of the partnership when the general partners have disabled themselves or wrongfully refused; and although they could be so read, we see no sufficient reason for doing so when in quite similar situations the cestui que trust or the preferred stockholder is allowed to do exactly that. The predecessor New York statute would hardly be read as going so far; we see no basis for thinking that, in its effort to achieve uniformity with other states, the legislature thought it would be altering New York law in this respect.

Id., at 298. Thus, the court implicitly addressed the argument discussed above concerning statutory construction and the treatment afforded an unanticipated situation to which the literal terms of a statute might be applied.

The court next addressed the defendants' argument that the legislature had intended the limited partner's right to demand dissolution as an exclusive remedy.

> "[W]e see no reason why such possibilities should prevent the speedier and more effective remedy of suit by a limited partner, any more than the beneficiary's right to ask that a trustee be

instructed or removed prevents suit by him when the trustee has wrongfully refused.

Id., at 299. The court noted that the common law right is narrowly drawn and requires "strong allegations and proof of disqualification or wrongful refusal by the general partners", id., but implicitly held that when this self-limiting test is met there is no good reason to impede the limited partner's most effective means of protecting the partnership and thus, indirectly, her interest in the partnership.

The thoughtful and well reasoned analysis in Klebanow has been echoed and supplemented in a number of subsequent cases, each holding that provisions identical to section 26 do not bar a limited partner's right to sue on behalf of the partnership. In Smith v. Bader, 458 F.Supp. 1184 (S.D.N.Y. 1978) the United States District Court for the Southern District of New York held that, under California law, a limited partner may maintain a derivative action on behalf of the partnership. Again, the court was confronted with the argument that a statute identical to U.C.A. §48-2-26 (1953) (i.e., §15526, California Corporations Code) prohibited such an action. The court noted that a strict interpretation of the statute "is not supported by the authorities" and that equity, which supplemented the code in cases not provided for by the act, (§15529 Cal. Corp. Code) "demands a liberal interpretation of the statute in the absence of a direct prohibition of a derivative cause." Id., at 1186. The court noted that under the facts before it, as in the case before this court:

. . . to preclude the derivative claims would

> effectively bar the partnership, and possibly the limited partners, from obtaining judicial relief as a result of the general partner's alleged self-dealing, conversion of assets and opportunities and breach of fiduciary duty. Such result would be inequitable.

Id. The court noted that the narrow right of a limited partner "is consistent with the purpose of the statute," and that "there is nothing to indicate the statute was intended to place restrictions upon the judicial remedies afforded limited partners in their dealings with the general partner and the partnership." Id., at 1186-87.

In reaffirming the conclusion reached by the Second Circuit in Klebanow, the New York Court of Appeals made a point that is particularly poignant with respect to the case sub judice: "[T]he purpose of [section 26] is solely to restrain limited partners from interfering with the right of the general partners to carry on the business of the partnership. The basis for this lawsuit is that the general partners have declined to carry on the business of the partnership by wrongfully refusing to enforce a partnership claim . . . ." Riviera Congress Associates v. Yassky, 18 N.Y.2d 540, 223 N.E.2d 876, 879 (Ct.App. N.Y. 1966). Because the general partner has refused to carry on the partnership business, the derivative action is not an interference, and the purpose of section 26 is not offended.

Provisions identical to U.C.A. §48-2-26 (1953) have been held not to affect the right of a limited partner to maintain a derivative action under the laws of Colorado, Hawaii, Michigan, and Ohio. See, Moore v. 1600 Downing St., Ltd., 668 P.2d 16, 19-20 (Colo. App. 1983); Phillips v. KULA 200, Wick Realty, Inc.,

629 P.2d 119, 122 (Haw.App. 1981); Jaffe v. Harris, 109 Mich.App. 786, 312 N.W. 2d 381, 384 (1981); Strain v. Seven Hills Associates, 75 A.D.2d 360, 429 N.Y.S.2d 424, 431 (1980) (applying Ohio law).

Finally, District Judge Timothy R. Hanson of the Third Judicial District Court of Utah has recognized that U.C.A. §48-2-26 (1953) does not prohibit a limited partner from suing on behalf of the partnership when the general partner is unable or unwilling to protect the partnership's interest. In Nagle v. Gramco Ltd. Partnership, C-82-9164 (Mem.Op. Feb. 18, 1983) Judge Hanson noted that the literal wording of the statute would appear to prohibit a limited partner's derivative suit. Judge Hanson realized, though, that this "was not and is not such as was contemplated as a desired result when the Legislature put into effect the Utah Limited Partnership Act, particularly Section 48-2-26, Utah Code Annotated, 1953 as amended." Id. at 2, R. p. 239. Plaintiffs respectfully contend that it was this step -- consideration of the legislative intent -- that Judge Daniels failed to take, and that this was error. As the Legislature had not contemplated the application of section 26 to situations such as existed in Nagle (and as exist here) Judge Hanson proceeded to determine whether such an application would be appropriate. After a careful review of the authorities, Judge Hanson concluded "that the application of the basic judicial principles of allowing persons to seek redress for wrongs through the courts, together with the application of fairness and common sense, require that this Court hold with the position enunciated [in

Klebanow], together with what appears to be the better reasoned treatises on the right of limited partnerships to commence actions against third parties where the general partner is unable or unwilling to act." Id. at 3, R. p. 240.

The cases that have held that a limited partner may not sue derivatively because of statutory provisions identical to U.C.A. §48-2-26 are remarkable in only one respect -- they have uniformly failed to undertake any probing analysis of the statute or the ULPA as a whole. Therefore, these cases are unpersuasive.

The first of these cases is Lieberman v. Atlantic Mutual Insurance Co., 385 P.2d 53 (Wash. 1963). The full extent of the court's analysis in Lieberman is that "a limited partner, not being a proper party to a suit brought by the partnership, [citing, R.C.W. 25.08.260, which is identical to U.C.A. §48-2-26], rather obviously cannot institute a suit on behalf of the limited partnership." Id. at 56. The opinion is wholly devoid of any analysis of the purpose of the section or of the Act as a whole. One other factor that may have influenced the result in Lieberman, and the court's summary disposition of the issue therein, is that the plaintiffs in Lieberman were limited partners in a partnership whose main asset was a vessel that had been deliberately destroyed by the general partner's act of arson. The limited partners were suing to collect insurance on the vessel. The equities in Lieberman were much less compelling than in a case where the general partner colludes with third parties to subvert partnership rights.

Several subsequent Washington cases have cited Lieberman for

the proposition that a limited partner does not have standing to maintain an action on behalf of the partnership. See, American Discount Corp. v. Saratoga West, Inc., 13 Wash.App. 890, 537 P.2d 1056 (1975); Fox v. Sackman, 22 Wash.App. 707, 591 P.2d 855 (1979). Neither of these cases discusses the issue and in both the relevant statements are merely dicta. These cases offer no rationale to persuade this court to adopt their apparent position.

A Florida case subject to the same criticism as Fox and American Discount Corp. is Amsler v. American Home Assurance Co., 348 So.2d 68 (Fla. App. 1977). Amsler cites only Lieberman as authority, contains no statutory analysis of its own, and there is no hint of any allegation that the general partner was unable or unwilling to pursue the claim that was the subject of the action.

A case that has been miscited in support of the proposition that a limited partner has no derivative right to sue on behalf of the limited partnership is Wroblewski v. Brucher, 550 F.Supp. 742 (D.C.Okla. 1982). See, e.g., Yale II Mining Associates v. Gilliam, 586 F.Supp. 893, 895 (D.C.Va. 1984); Defendants' Reply Memorandum to Plaintiffs' Memorandum in Opposition to Summary Judgment, Bagley v. Virginia Beach Federal Savings, R. p. 250. Reliance on Wroblewski in this regard is embarrassingly misplaced. While the "headnotes" numbered 2, 6 and 9 seem to support the proposition that "[u]nder California law, general partner ordinarily controls litigation on behalf of limited partnership and limited partner may not intervene on its behalf",

550 F.Supp. at 743, hn. 9, the court itself expressly recognizes that this statement is dicta only, id. at 748, and, in fact, states:

> It is settled law that a limited partner in a California limited partnership, either by virtue of his right to sue the partnership to enforce his rights against it, . . . or, by analogy to corporate law and the application of general equitable principles, . . . would have a right to intervene or file a derivative suit in the event of fraud or collusion.

Id., fn. 8 (statutory references omitted). Thus, Wroblewski, cited by defendants, clearly supports the plaintiffs' position with respect to the issue before this court.

Similarly, defendants' reliance on Bedolla v. Frazer, 52 Cal.App.3d 118, 125 Cal.Rptr. 50 (1975) in their Reply Memorandum below is misplaced. R. p. 250. First, any statement in Bedolla concerning a limited partner's derivative suit is dictum, as the case involved direct claims (brought as a class action) of the limited partners against the general partners and third parties. Second, the exact statement in Bedolla relevant to the instant case is: "While as a general rule a limited partner may not bring a lawsuit on behalf of the limited partnership without assuming the liability of a general partner . . . ." Id. at 66 (emphasis supplied). This statement implicitly supports plaintiffs' position. It implies an exception to the "general" rule, which plaintiffs respectfully suggest is applicable given the circumstances present here.

Another case in which it is stated that "[t]he only person authorized to institute suits on behalf of the limited partnership is . . . the general partner" is Coe v. United

States, 502 F.Supp. 881, 885 (D.C. Ore. 1980). This statement is merely dictum in Coe, and is supported only by citation to Fox v. Sackman, discussed above. Coe lacks any analysis whatsoever which might persuade this court regarding the issue at hand.

It is held in Yale II Mining Associates v. Gilliam, 586 F.Supp 893, 895 (D.C. Va.1984) that only a general partner may bring suit on behalf of a limited partnership under statutes identical to §48-2-26. Again, no statutory analysis is undertaken. The Court merely cites Lieberman, Fox, and Coe, previously discussed, Conrad Milwaukee Corp. v. Wasilewski, 30 Wis.2d 481, 483, 141 N.W.2d 240, 242 (1966), which the Yale II court itself notes contains only dictum on the issue, and Wroblewski, which, as has been previously noted, supports the contrary position. Yale II is not a decision that this court should rely upon in determining whether Section 26 bars derivative actions by limited partners.

This court should adopt the position of every jurisdiction that has thoughtfully considered the issue -- that the statutory provision found at U.C.A. § 48-2-26 (1953) does not bar a limited partner's common law right to sue derivatively on behalf of the partnership when the general partner is unable or unwilling to protect the partnership's interests. This position is mandated by the rules of statutory construction and the requirements of equity, fairness and common sense.

C. The Policy Arguments[1] Most Commonly Made Against The Recognition Of A Limited Partner's Derivative Right Lack

Substance In Light Of The Narrow, Self-Limiting Nature Of The Common Law Equitable Right.

Two policy arguments are commonly made in support of the position that a limited partner should not be able to bring a derivative action. First, it is argued that a derivative right will allow limited partners to interfere with the management of the partnership. See Defendants' Reply Memorandum, R. p. 253. Second, it is argued that a derivative right will open the floodgate to a torrent of wasteful and unnecessary litigation. Id., R. p. 255. Both of these arguments fail for the same reason--they ignore the fact that the common law derivative right is by its nature and origin limited to situations where the general partner is unable or unwilling to protect the partnership's interests because of fraud, collusion or other wrongful conduct by the general partner or the general partner and third parties.

Every case that has recognized the common law right has also recognized its narrow parameters. See, e.g., Klebanow v. New York Produce Exchange, 344 F.2d at 299. See also Wroblewski v. Brucher, supra, 550 F.Supp at 748, f.n. 8 (derivative right "in the event of fraud or collusion"); Smith v. Bader, 458 F.Supp at

[1]Plaintiffs recognize that "policy" arguments concerning the ability of limited partners to bring derivative actions are properly raised before this court only as they may come in to play through the various rules of statutory construction addressed above. Thus, the appropriate uses of the arguments addressed herein are in connection with the rules that statutes should be construed so that they are internally consistent (interference with management argument) and to promote judicial efficiency (wasteful litigation argument). Plaintiffs address these arguments in this separate section in order to stress that these arguments lack substance because their premises ignore the limited nature of the common law right.

1186 ("general partner's alleged self-dealing, conversion of assets and opportunities and breach of fiduciary duty"); Moore v. 1600 Downing St., Ltd., 668 P.2d at 19 (derivative action for breach of fiduciary duty by general partners "if the general partners refuse to or are unable to bring such an action"); Phillips v. KULA 200, Wick Realty, Inc., 629 P.2d at 122 ("if the limited partnership refuses to bring an action for damages against its general partners"); Jaffe v. Harris, 312 N.W.2d at 383 (implicitly; complaint alleged conversion, self-dealing and breach of fiduciary duty by general partner); Riviera Congress Associates v. Yassky, 223 N.E.2d at 879 (derivative action allowed to enforce partnership claims "when those in control of the business wrongfully decline to do so"); Strain v. Seven Hills Associates, 429 N.Y.S.2d at 425 (implicitly; complaint alleged breach of fiduciary duty of general partner by subjecting economic well being of partnership to non-partnership interests independently owned by general partner); Nagle v. Gramco Limited Partnership, at 3, R. p. 239, (unreasonable to deny derivative relief "where the general partner and [a third party] acting in concert or otherwise are damaging limited partners").

The derivative action is a narrow exception to the general rule prohibiting interference with the management of an entity, whether it be a corporation, trust, or limited partnership. The ability to bring a derivative action is, inherently, a very narrow right. Thus, the recognition of this right will not lead to a flood of spurious litigation intended to harass or interfere with the management of limited partnerships.

Incidentally, plaintiffs note that the circumstances in which derivative actions are appropriate break down into two general categories. The first is where the partnership has a claim against the general partner for a breach of its fiduciary duty or some other misconduct that has damaged the partnership. In this case the derivative action is appropriate because the general partner is obviously not going to sue itself. This situation is present in the instant case. The second category exists where the partnership has claims or defenses against a third party, but the claims are not being asserted because the general partner is disabled or has ties to the third party that make it either unable or unwilling to do so. Under these circumstances the derivative action must be supported by "strong allegations" specifying the reasons why the general partner cannot or will not act. This situation is also present in the instant case. Plaintiffs have met the test involved in the second category through their specific pleadings alleging that JSC, the general partner, is actually the alter ego of the lenders, and by setting forth specific facts supporting this allegation. There was no assertion in the court below, nor can there be in this appeal, that the partnership failed to plead facts to state a claim against the general partner and the lenders that control it. Defendants claimed only that the limited partners could not pursue partnership claims derivatively on its behalf. For the purposes of this appeal, the sufficiency of plaintiffs' allegations is established.

The "policy" objections commonly made in regard to the

recognition of a limited partner's narrow derivative right are based upon a misconception of the limited nature of the right. The objections are ill-founded and should be disregarded by this court in determining whether U.C.A. § 48-2-26 bars a limited partner's common law right to sue on behalf of the partnership when the general partner is unable or unwilling to protect the partnership's interests. Indeed, given the equities involved, this is one "floodgate" which <u>should</u> be kept open to protect limited partnerships and their partners.

CONCLUSION

Is there a right without a remedy? Confronted by this question in the context of maladministration, breach of fiduciary duty and fraud or collusion by a general partner in a limited partnership setting, numerous courts have answered "no". The remedy is the derivative action, recognized at common law under circumstances where limited partners can demonstrate fraud, collusion, self dealing, disability or other breaches of fiduciary duty on the part of the general partner at the expense of the partnership. This common law rule of equity has its roots in similar actions historically recognized with respect to corporate shareholders and trust beneficiaries.

Parties opposing the derivative right of limited partners to sue on behalf of a limited partnership under these circumstances have asserted as a bar the provisions of statutes similar or identical to 48-2-26 U.C.A. (1953). However, the legislative history of the ULPA does not support the conclusion that this section was intended to bar derivative actions brought by limited partners under appropriate circumstances. Nor do other rules of statutory construction support such a finding. The courts which have discussed these issues have concluded that the statute is not a bar to derivative actions by limited partners under appropriate circumstances. The decisions which have held to the contrary have uniformly failed to discuss the issues and have failed to provide any rationale to support their intepretation of the statute.

Under the circumstances of this case, The Jeremy, Ltd. will

be irreparably damaged and without a remedy unless this court recognizes the right of its limited partners to sue the wrongdoers on its behalf through the vehicle of this derivative suit. Equity, common sense and public policy require this result. The general partner here will not sue itself nor the lenders which own and control it.

The arguments which have been raised to oppose the derivative right of limited partners under these circumstances are not meritorious. Courts which have recognized the derivative right have also circumscribed it with requirements that the plaintiffs make a showing that the general partner is disabled or otherwise wrongfully failing to act to protect partnership interests. Unwarranted interference in the management of limited partnerships is contrained because of the narrow scope of the derivative action. Because of this same limited scope, the recognition of a derivative right in limited partners will not open the "floodgates" to unwarranted litigation.

While the provisions of Section 26 could be read to prohibit derivative actions by limited partners, it is clear that they need not be and it is further clear that they should not be under the better reasoned authority and circumstances of this case.

The Order of Dismissal should be reversed and this case should be remanded for further proceedings in the District Court.

DATED this 23rd day of January, 1987.

Jeffrey L. Silvestrini
COHNE, RAPPAPORT & SEGAL
Attorneys for Plaintiffs/Appellants
Bagley Corporation and Gerald H. Bagley

MAILING CERTIFICATE

The undersigned hereby certifies that four true and correct copies of the foregoing BRIEF OF APPELLANT were mailed, postage fully prepaid, on the 23rd day of January, 1987 to each of the following:

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IN THE THIRD JUDICIAL DISTRICT COURT FOR SUMMIT COUNTY

STATE OF UTAH

BAGLEY CORPORATION, a Utah corporation, and GERALD H. BAGLEY, an individual, individually and derivatively for and on behalf of THE JEREMY LTD., a Utah limited partnership,

Plaintiffs,

vs.

VIRGINIA BEACH FEDERAL SAVINGS AND LOAN ASSOCIATION, a foreign corporation, GUARANTY NORTHSTATE, fka NORTHSTATE SAVINGS AND LOAN OF SOUTHERN PINES, a foreign corporation, ATLANTIC PERMANENT FEDERAL, a foreign corporation JEFFERSON SAVINGS & LOAN, a foreign corporation, WILLIAM T. BLAIR, JR., WILLIAM H. BANDY, HARRY H. KNICKERBOCKER, T. LINWOOD MAY, NANCY BOLTEN, JOHN LIVINGSTONE and J. RUTHERFORD, individuals, THE JEREMY LTD., a Utah limited partnership, JEREMY SERVICE CORPORATION, a Utah corporation, and ASSOCIATED TITLE COMPANY, INC., a Utah corporation,

Defendants.

ORDER AND JUDGMENT
OF
DISMISSAL

No. .....

FILED

JUL 3 1986

Clerk of Summit County

BY: .....
Deputy Clerk

Civil No. 8725

The Motion to Dismiss of Defendants Virginia Beach Federal Savings & Loan Association, Atlantic Permanent Federal Savings & Loan Association, North State Savings & Loan of Southern Pines and Jefferson Savings & Loan Association ("Lenders") having come on regularly for hearing before the above-entitled Court on Friday, May 30, 1986, at the hour of 2:00 p.m., Jeffery L. Silvestrini of Cohne, Rappaport & Segal appearing for Plaintiffs, George A. Hunt of Snow, Christensen & Martineau appearing for Lenders, M. David Eckersley of Houpt and Eckersley appearing for the individual Defendants (except Mr. Blair) and R. Dennis Ickes appearing for Defendants Jeremy Service Corporation and The Jeremy Ltd., and the Court having heard the arguments of counsel and having reviewed the Memoranda and other pleadings on file, and Messrs. Eckersley and Ickes having stated to the Court that their clients joined in the motion of Lenders, and the Court being fully advised in the premises and good cause appearing,

Now, therefore, IT IS HEREBY ORDERED, ADJUDGED AND DECREED that:

1. The Motion to Dismiss shall be and the same hereby is granted;

2. All Plaintiffs' claims of a derivative nature against Defendants or any of them (claims 1-9 and 12-15 inclusive) shall be and the same are hereby dismissed;

3. Any remaining claims of Plaintiffs, if any, which are either direct claims or claims where the object is to enforce a limited partner's right against or liability to the partnership, shall be re-pleaded by way of Amended Complaint, the same to be filed within forty (40) days from entry hereof;

4. With respect to the claims dismissed under Paragraph numbered 2 above, there is no just reason for delay and said judgment of dismissal shall be deemed final in accordance with Rule 54(b), Utah Rules of Civil Procedure.

DATED and entered this 26 day of June, 1986.

BY THE COURT:

Scott Daniels
District Court Judge

Approved as to form:

SNOW, CHRISTENSEN & MARTINEAU

By_____
George A. Hunt

COHNE, RAPPAPORT & SEGAL

By_____
Jeffery L. Silvestrini

HOUPT & ECKERSLEY

By _____
M. David Eckersley

_____
R. Dennis Ickes

State of Utah)
County of Summit) ss

I, Douglas R. Geary, Clerk of the District Court in and for Summit County, State of Utah, do hereby certify that the foregoing is a full, true and correct copy of the Order & Judgment of Dismissal in the matter of the entitled #3725 as the same appears of record and upon file in my office.

IN WITNESS WHEREOF I have hereunto set my hand and affix the seal of said Court this 1st day of Aug 1986

Douglas R. Geary Clerk

By Joyce D. Ward Deputy Clerk